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Case Number 36,2013

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DAVID F. MILLER III,	)	
	)	
Plaintiff Below, Appellant,	)	No. 36, 2013
	)	
	)	Court below: Court of Chancery of the State of Delaware
v.	)	
	)	
PALLADIUM INDUSTRIES, INC.,	)	
	)	C.A. No. 7475-VCN
	)	
Defendant Below, Appellee.	)	
	)	

APPELLANT DAVID F. MILLER III'S OPENING BRIEF

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NATURE OF PROCEEDINGS

The plaintiff, David F. Miller, III ("Mr. Miller") is the former president, chief executive officer, and director of defendant Palladium Industries, Inc. ("Palladium"), its operating subsidiary VisionAid, Inc. ("VisionAid"), and the predecessors of Palladium and VisionAid. Mr. Miller brought this action pursuant to Palladium's bylaws seeking to enforce his right to mandatory advancement of the legal fees and expenses he incurred, and continues to incur, defending a breach of fiduciary duty action[1] brought by Palladium and VisionAid.

Palladium moved for judgment on the pleadings on the grounds that Palladium's bylaws ("Bylaws") provide for discretionary (not mandatory) advancement, and that Palladium's board exercised it discretion to deny Mr. Miller advancement. After briefing and oral argument, the Court of Chancery issued an opinion[2] dismissing the complaint.

On January 28, 2013, Mr. Miller filed a timely appeal from the Court of Chancery's decision. (Transaction ID 49161537). This is Mr. Miller's opening brief on appeal.

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[1] The underlying fiduciary duty action is captioned *VisionAid, Inc., et al. v. Miller*, C.A. No. 7083-VCN ("Underlying Action").

[2] Opinion and Order of the Delaware Court of Chancery ("Op.") (Filing ID 48688810) is attached hereto as Exhibit 1.

SUMMARY OF ARGUMENT

1. The Court of Chancery's ruling that the Bylaws provided for mandatory advancement to the point that Palladium's board decides not to grant advancement, should be reversed because it ignores the plain language of the Bylaws and renderers provisions thereof illusory and meaningless. The Bylaws should be read to provide mandatory advancement rights to Mr. Miller, which is the only reasonable reading of the Bylaws, giving effect to the mandatory "shall" as used therein.

2. Should this Court determine the Bylaws are ambiguous, the Court should construe them against Palladium pursuant to the doctrine of *contra proferentem* and find that the advancement provisions provide for mandatory advancement. To the extent ambiguity remains after application of *contra proferentem*, the case must be remanded for the Court of Chancery to consider extrinsic evidence.

STATEMENT OF FACTS

A. The Claim For Advancement

Mr. Miller served as President and CEO of VisionAid and Palladium from 1992 until August 2011[3] (A7). During this time he also served as a director of VisionAid and Palladium.[4] *Id.*

Palladium, known as Bouton Corporation until June 2011, is a Delaware corporation, which owns 100% of its operating subsidiary, VisionAid, also a Delaware corporation. VisionAid was known as H.L. Bouton Company until June 2011[5] (A6). VisionAid manufactures, imports and distributes emergency eyewash tanks, flexible side shields for use on various types of spectacles, emergency eyewash solutions, and lens care products, including lens wipes and various tissues and sprays (A7).

At a meeting held on December 19, 2002, the board of directors of Palladium unanimously approved an amendment to its bylaws to add ARTICLE X, Indemnification of Officers, Directors and Others (A8). Section 1 of Article X provides for indemnification for each person who is a party to an action "by reason of the fact that he or she, …, is or was a director or officer, of the corporation…"

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[3] Citations to "A_" refer to the appendix filed with this brief.

[4] Mr. Miller served as President and CEO and as a director of VisionAid's and Palladium's predecessor companies from 1983 to 1992 (A7).

[5] Both entities, and the predecessor entities, are referred to by their current names throughout this brief.

(A8; A52). Section 1 then provides that:

> The right to indemnification conferred in this Article X shall be a contract right and, ***subject to Sections 2 and 5 hereof, shall include the right to be paid by the corporation the expenses incurred in defending any such proceeding in advance of its final disposition.*** The corporation may, by action of the Board of Directors, provide indemnification to employees and agents of the corporation with the same scope and effect as the forgoing indemnification of directors and officers.

(A8-9; A52-53)(emphasis added).

Section 2 of Article X provides for a process by which, among other things, the officer or director may enforce his or her right to indemnification or advancement (A9; A53). In relevant part, Section 2 provides:

> Section 2. Any indemnification of a director or officer of the corporation under Section 1 of this Article X or advance of expenses under Section 5 of this Article X shall be made promptly, and in any event within thirty days, upon the written request of the director or officer…. If the corporation denies a written request for indemnification or advancing of expenses, in whole or in part, or if payment in full pursuant to such request is not made within thirty days, the right to indemnification or advances as granted by this Article X shall be enforceable by the director or officer in any court of competent jurisdiction. Such person's costs and expenses incurred in connection with successfully establishing his or her right to indemnification, in whole or in part, in any such action shall also be indemnified by the corporation….
>
> Section 5 provides:
>
> Section 5. Expenses incurred by any person described in Section 1 of this Article X in defending a proceeding ***shall be paid by the corporation in advance of such proceeding's final***

> ***disposition*** unless otherwise determined by the Board of Directors in the specific case upon receipt of an undertaking by or on behalf of the director or officer to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the corporation. Such expenses incurred by other employees and agents may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate.

(A9; A53-54) (emphasis added).

On December 2, 2011, VisionAid filed the Underlying Action against Mr. Miller. On March 30, 2012, an amended complaint was filed, which, among other things, added Palladium as a plaintiff (A11). Plaintiffs in the Underlying Action allege that Mr. Miller breached his fiduciary duties as an officer and/or director of Palladium and VisionAid and assert claims for misappropriation, waste and conversion of assets (*Id.*).

By letter dated March 19, 2012, Mr. Miller demanded that Palladium advance the expenses incurred in the Underlying Action, pursuant to the Bylaws (*Id.*; *see also* A44-48). Mr. Miller's March 19 letter included the required undertaking by him to repay amounts advanced to him "if and to the extent it ultimately is determined that [he is] not entitled to indemnification in connection with that action" (*Id.*; A11).

Purportedly exercising its discretionary right, Palladium denied Mr. Miller his right to advancement of expenses by letter dated April 18, 2012. Palladium

stated:

> The Palladium board has considered Mr. Miller's request for advancement of fees. In a duly noticed special meeting of the directors, held on April 17, 2012, the board has voted to deny the request as not being in the Company's best interest. The board based this decision on multiple independent reasons. In the board's view, each reason standing alone merits denial of the request. Those reasons include, without limitation:
>
> 1. Were the board to advance fees and expenses, Palladium and VisionAid would not have funds adequate to meet operating expenses and their own litigation expenses;
>
> 2. The company's impaired financial condition and lack of sufficient funds is due in large part to Mr. Miller's conduct at issue in the litigation;
>
> 3. In light of the facts known to Palladium, the likelihood that Mr. Miller would be required to repay any advanced funds is high;
>
> 4. The likelihood Mr. Miller would be able to perform his repayment obligation is low. Despite Palladium's request, Mr. Miller has not offered to provide collateral that would be sufficient to secure his repayment obligation nor has he provided evidence of his ability to satisfy both the expected judgment and his repayment obligation;
>
> 5. It is not in the company's interest to finance an opposition to the company's claims, especially when the would-be recipient of such financing has no demonstrated ability to repay any funds advanced.

(A49-51).

After receiving Palladium's denial letter, Mr. Miller filed this action to

enforce his right to mandatory advancement.

B. The Court of Chancery's Opinion

Palladium moved for judgment on the pleadings on the ground that the Bylaws provide for discretionary, not mandatory, advancement. Palladium argued that the provision in Section 5 italicized below, gives the board of directors the discretion to deny advancement.

> Expenses incurred by any person described in Section 1 of this Article X in defending a proceeding shall be paid by the corporation in advance of such proceeding's final disposition *unless otherwise determined by the Board of Directors in the specific case* upon receipt of an undertaking by or on behalf of the director or officer to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the corporation…

(A9; A54)(emphasis added).

Of course, this reading of the Bylaws renders the word "shall", used in Sections 1, 2 and 5, meaningless, as the Court of Chancery correctly pointed out at oral argument:

> THE COURT: So what we have is they've got to give him advancement unless they don't want to.
>
> MR. BERMAN: Unless, within 30 days, they come to a determination not to provide him with advancement.
>
> THE COURT: There's a time hook on it, *but the word* ***"shall" is about as illusory in this set of by-laws as any time I've ever seen the word "shall" used.*** Let me try to highlight what I'm worried about here. If it were "shall pay advancement unless the Red Sox won the World Series in the preceding calendar year," that's a factual

> condition. I understand that you can condition advancement on all kinds of factual events, and whether it makes sense or not doesn't matter to me. If it's there, it's what the terms of the agreement are, or the by-laws. But where it is "you shall do it unless you don't want to do it" just turns to mush. Now, maybe the answer is if it turns to mush, there's no right to advancement, but it is, at best, clumsily drafted. And I worry where we see "shall" so many times that all of a sudden the right disappears. Just because the directors don't want to pay it -- and I understand why the directors don't want to pay it, because they have an adverse relationship with Ms. Miller's client.

(A58-59)(emphasis added).

Despite the Court of Chancery's recognition at oral argument, we think correctly, of the fatal flaw in Palladium's interpretation of the Bylaws, the Court granted Palladium's motion, after framing the issue as "Does the language following 'unless' [in Section 5 of the Bylaws] convert what otherwise seems to be a mandatory right to advancement provision ('[expenses … shall be paid…') into one that nevertheless, remains subject to the board's taking action specifically to reject the advancement request." (Op. at 6). The Court of Chancery then ruled:

> Palladium's Bylaws do, however, provide for advancement that, at least in some instances, amounts to mandatory advancement. The only reading of Palladium's advancement provision is that advancement shall be paid (*i.e.*, up to this point, it is mandatory) unless Palladium's board specifically determines not to pay a specific advancement. In other words, Palladium must advance legal fees and expenses if the board does not adopt a contrary directive. This is the only fair reading of the pertinent provision (Art. X) of Palladium's Bylaws. Failure of the board to act in a specified time after receipt of a request for advancement will leave the request as a mandatory one. Here, the board acted in a timely fashion—within roughly thirty days from the date of Miller's demand.

(Op. at 8).

For the reasons discussed below, the Court of Chancery's ruling renders the word "shall" meaningless and results in the alleged mandatory advancement being illusory. In addition, under Palladium's theory and the lower Court's ruling, the right to mandatory advancement would exist only when the board of directors breaches its fiduciary duty by allowing the 30 day period to lapse with no action by the board. This is not a reasonable reading of the Bylaws and therefore, the Court of Chancery's decision should be reversed, with a ruling that the Bylaws provide for mandatory advancement and then the case should be remanded to allow the Court of Chancery to address the affirmative defenses raised by Palladium.

In the alternative, if extrinsic evidence should be considered, the Court of Chancery decision must be reversed and the case remanded to allow the Court of Chancery to consider such evidence.

ARGUMENT

I. THE CHANCERY COURT ERRED IN RULING THAT MR. MILLER IS NOT ENTITLED TO MANDATORY ADVANCEMENT

A. Question Presented

Under the rules of construction of bylaws, does the plain meaning of the Bylaws grant mandatory advancement rights?

This question was raised below in Palladium's opening brief in support of its motion for judgment on the pleadings (OB at 5-8) (Filing ID 44794115), in Miller's answering brief in opposition to that motion (AB at 6-15) (Filing ID 45223389), and in Palladium's reply brief in further support of that motion (RB at 1-7) (Filing ID 45357764).

B. Scope of Review

In an appeal from a decision of the Court of Chancery, the Supreme Court reviews conclusions of law *de novo*. *Stegemeier v. Magness*, 728 A.2d 557, 561 (Del. 1999). The standard of review in a motion for judgment on the pleadings "is to determine whether the court committed legal error in formulating or applying legal precepts." *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1204 (Del. 1993). Because the Court of Chancery here decided a motion for judgment on the pleadings, all of its rulings were conclusions of law. *Id.*

The question presented is a matter of contractual interpretation. Because the Bylaw is clear and unambiguous this Court should construe it in a way that gives it its "ordinary meaning." *Citadel Holding Corp. v. Roven*, 603 A.2d at 824 (Del. 1992). The Bylaws' "construction should be that which would be understood by an objective, reasonable third party". *Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1159 (Del. 2010).

C. Merits of Argument

1. Rules of Construction of Bylaws

Mandatory advancement provisions encourage qualified persons to become or remain as directors because it assures them "that they may resist lawsuits that they consider meritless, free of the burden of financing (at least initially) their own legal defense." *In re Central Banking Sys., Inc.*, 1993 WL 183692, at *3 (Del. Ch. May 11, 1993)[6](citation omitted); *see Homestore, Inc. v. Tafeen*, 888 A.2d 204, 218 (Del. 2005) (explaining that advancement provisions promote the public policy of attracting the most capable people into corporate service); *Havens v. Attar*, 1997 WL 55957, at *13 (Del. Ch. Jan. 30, 1997) (citation omitted). Delaware's policy favoring advancement to corporate officials mandates that any doubt be resolved in favor of advancement. *See Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 404 (Del. Ch. 2008) ("the Delaware policy gloss favoring advancement to

[6] A compendium of unreported cases is being filed concurrently with this brief.

corporate officials supports resolving [] ambiguity in favor of advancement"). Consistent with the strong public policy of indemnification and advancement, "Delaware courts have broadly construed mandatory advancement provisions to provide corporate officials with immediate interim relief from the personal out-of-pocket financial burden of paying significant expenses often involved in legal proceedings." *Brown v. Liveops, Inc.*, 903 A.2d 324, 327-28 (Del. Ch. 2006) (citation omitted).

Courts apply the general rules of contract interpretation to bylaws, including indemnification and advancement provisions. *See Sun-Times Media Group, Inc.*, 954 A.2d at 389. "Contract terms themselves will be controlling when they establish the parties' common meaning so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language." *Eagle Indus. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997); *see also Rhone-Poulenc Basic Chemicals Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992)("The true test is not what the parties to the contract intended it to mean, but what a reasonable person in the position of the parties would have thought it meant."). When contracts are plain and unambiguous the court only needs to look at the language of the contract. *See Citadel Holding Corp*, 603 A.2d at 822. A court should "read a contract as a whole" and each provision and term must be given effect "so as not to render any

part of the contract mere surplusage." *Osborn*, 991 A.2d at 1159; *see also Bank of New York Mellon v. Commerzbank Capital Funding Trust II*, 2013 WL 1136821, at *8 (Del. Mar. 19, 2013)("It is settled that a contract must be read as a whole and in a manner that will avoid any internal inconsistencies, if possible."); *Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396-97 (Del. 2010); *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at *6 n.24 (Del. Ch. July 14, 2009) (the court must interpret a contract to give effect to all the terms and, if possible, reconcile all of the provisions of the contract, when read as a whole). A contract should not be interpreted to '"render any provision or term illusory or meaningless.'" *Stockman*, 2009 WL 2096213, at *6 n.24.

2. <u>The Bylaws Mandate Advancement</u>

Palladium's Bylaws specifically mandate indemnification "to the fullest extent which it is empowered to do so" by law when an individual is involved in civil litigation "by reason of the fact that he, …, is or was a director or officer, of the corporation or is or was serving at the request of the corporation as a director" and requires that this right "***shall*** include the ***right*** to be paid by the corporation the expenses incurred in defending any such proceeding ***in advance*** of its final disposition…" (Op. at 2; A51) (emphasis added).

The word "shall" indicates a mandatory obligation to provide advancement. *See e.g., Schoon v. Troy Corp.*, 948 A.2d 1157, 1169 (Del. Ch. 2008) ("This court

must first note the word 'shall' in section 9 establishes a right to mandatory advancement"); *Underbrink v. Warrior Energy Servs. Corp.*, 2008 WL 2262316, at *7 (Del. Ch. May 30, 2008) (stating that bylaw providing company "shall" advance expenses provides for "mandatory advancement"); *VonFeldt v. Stifel Fin. Corp.*, 1999 WL 413393, at *3 (Del. Ch. June 11, 1999) ("By using the mandatory word 'shall' in the indemnification bylaw, Stifel has contractually agreed to indemnify the persons covered by the bylaw, including VonFeldt"); *Citadel Holding Corp.*, 603 A.2d at 823 (the indemnification agreement "renders the corporation's duty mandatory in providing that expenses *shall* be paid in advance" (emphasis in original)); s*ee also, Zurich Am. Ins. Co. v. St. Paul Surplus Lines, Inc.*, 2009 WL 4895120, at *7 n.55 (Del. Ch. Apr. 14, 2009)("In both contracts and statutes, the term 'shall' is used to make an act mandatory") (citation omitted).

As Palladium admits, a corporation is permitted under Delaware law to provide for mandatory advancement (OB at 7); *see also Citadel Holding Corp.*, 603 A.2d at 823; *Underbrink*, 2008 WL 2262316, at *7; *Reddy v. Electronic Data Sys. Corp.*, 2002 WL 1358761, at **3-4 (Del. Ch. June 18, 2002). Palladium's grant of mandatory advancement is contained in Section 1 of Article X, which provides that a director "shall be indemnified …to the fullest extent which it is empowered to do so" under the Delaware General Corporation Law (Op. at 2). This section goes on to provide that the right to indemnification "***shall*** include the

right to be paid by the corporation the expenses incurred in defending any such proceeding in advance of its final disposition." (*Id.*).

Palladium and the lower Court ignored Section 1 and gave no meaning to the "shall" in that section. Palladium argued that because the advancement provision in Section 1 was "subject to Sections 2 and 5" any right granted in Section 1 was taken away by the Sections 2 and 5, except in a circumstance that would be contrary to Delaware law. Palladium and the lower Court focused on the below highlighted provision of Section 5:

> Section 5. Expenses incurred by any person described in Section 1 of this Article X in defending a proceeding shall be paid by the corporation in advance of such proceeding's final disposition **unless otherwise determined by the Board of Directors in the specific case** upon receipt of an undertaking by or on behalf of the director or officer to repay such amount if it shall ultimately be determined that he or she is not entitled to be indemnified by the corporation.

(Op. at 3; A54) (emphasis added). Palladium argued that this passage makes the advancement provision subject to the discretion of the board. It's only attempt to give any meaning to the "shall" was to assert that if the board did not act on a demand for advancement within 30 days (referencing the time period in Section 2 after which a director can pursue legal action to enforce his rights to advancement), the right to advancement, by default, becomes mandatory. If, however, the board acts (at a meeting or by written consent) to deny advancement within that 30 day period, the advancement provision becomes discretionary. The Court of Chancery

accepted this interpretation of the Bylaw (*see* Op. at 8). This interpretation, however, should fail for several reasons.

First, this construction ignores the right to mandatory advancement granted in Section 1 of Article X. Neither Palladium nor the Court of Chancery provided any reason why the Bylaws would grant mandatory advancement in Section 1 and then take it away in Section 5. Such a result renders the provisions inconsistent, which is contrary to Delaware law on contract construction. *See Osborn*, 991 A.2d at 1159; *see also Kuhn*, 990 A.2d at 396-97; *see Stockman*, 2009 WL 2096213, at *6 n.24 and cases cited therein, including *In re Cencom Cable Income Partners, L.P. Litig*., 2000 WL 640676, at *5 (Del. Ch. May 5, 2000) ("In order to discern the intent of the parties, the contract should be read in its entirety and interpreted to reconcile all of the provisions of the agreement")(citations omitted).

Second, the Court of Chancery's holding renders the word "shall" in Sections 1 and 5 of the Bylaws meaningless or, contrary to Delaware law, applies a meaning of "may" to the word "shall". *See e.g., Schoon*, 948 A.2d at 1169 ("This court must first note the word 'shall' in section 9 establishes a right to mandatory advancement"); *Underbrink*, 2008 WL 2262316, at *7 (stating that bylaw providing company "shall" advance expenses provides for "mandatory advancement").

Such a reading also cannot be reconciled with other provisions of the Bylaws that do provide the board of directors with discretion to decide whether to grant advancement rights. For example, Section 5 further provides that employees and agents "**may be so paid** upon such terms and conditions, if any, as the Board of Directors deems appropriate." If advancement rights are left to the discretion of the board, then there is no need for the use of "shall" for directors and "may" for employees (A54) (emphasis added). Likewise, Section 1 of Article X provides that "The corporation **may**, by action of the Board of Directors, provide indemnification to employees and agents of the corporation with the same scope and effect as the foregoing indemnification of directors and officers" (A53) (emphasis added). Furthermore, Section 6 of Article X provides that those not covered by Section 1, "**may** be indemnified to the extent authorized at any time or from time to time by the Board of Directors" (A54).[7] The inclusion of these clearly permissive provisions confirms that if the intent of the Bylaws was to only provide permissive advancement to directors/officers, Palladium could have done so clearly by using the word "may" instead of "shall". *See Stockman*, 2009 WL

[7] Section 6 provides:

> Persons who are not covered by the foregoing provisions of this Article X and who are or were employees or agents of the corporation, or who are or were serving at the request of the corporation as employees or agents of another corporation …may be indemnified to the extent authorized at any time or from time to time by the Board of Directors.

(A54).

2096213, at *7 (finding advancement was mandatory in part because other non-advancement related provisions in the partnership agreement plainly and clearly gave the general partner discretion and that the partnership had not provided an explanation for "why two provisions that purport to achieve the same purpose would be drafted so differently in the same agreement."). Because permissive language was used in the Bylaws, it demonstrates the drafters knew how to use such language if it was their intent to do so (with respect to directors and officers). *See Seaford Golf & Country Club v. E.I. duPont de Nemours & Co.*, 925 A.2d 1255, 1263 (Del. 2007) (stating "all [defendant] needed to do was employ language similar to that used" in other contracts between the parties); *Shiftan v. Morgan Joseph Holdings, Inc.*, 57 A.3d 928, 933, 938 (Del. Ch. 2012)(noting a lack of symmetry between two contract provisions within the same contract and finding the non-symmetric provisions did not have the same meaning); *EBG Holdings LLC v. Vredezicht's Gravenhage 109 B.V.*, 2008 WL 4057745, at *10 (Del. Ch. Sept. 2, 2008) (stating by expressly referring to affiliates "within the ambit of § 15.1 relating to indemnification while referring only to parties in the jurisdiction provision, manifested an intent *not* to include Affiliates under [the jurisdiction provision] § 16.8.").

Third, the Court of Chancery's attempt to reconcile the mandatory "shall" used in the Bylaws with Palladium's argument results in an unreasonable reading.

The lower court ruled that "[t]he only reading of Palladium's advancement provision is that advancement shall be paid (*i.e.*, up to this point, it is mandatory) unless Palladium's board specifically determines not to pay a specific advancement." (Op. at 8) That is, the Bylaws "assured its covered officers, directors, and employees of advancement unless the board acted to deny the right in a particular case." (*Id*. at 9). Of course, that is no assurance at all because if the Palladium board had the right to deny advancement, Mr. Miller had no right to advancement at all, at any time (i.e. you shall provide advancement, unless you don't want to). Moreover, the lower Court's ruling would lead to an absurd result. For example, if the right to advancement was mandatory until the board decided to deny the right, a claimant would be entitled to have his/her expenses advanced while the right was mandatory, *i.e.*, until the board rejected it. This would allow a claimant to wait until a substantial amount of expenses had been incurred, then make a demand on the board for advancement and be entitled to recover those expenses submitted up to the point that the right to advancement was denied by the board, and only future expenses would be denied. We don't think that this is the proper result, but it is the logical result under the lower Court's ruling.

Under this reasoning, the right to mandatory advancement is illusory because a director has the right (supposedly) unless the board acts otherwise. When presented with a demand for advancement, unless the right is to mandatory

advancement, the board of directors must exercise its business judgment to make a determination whether granting advancement is in the best interest of the corporation. *See Havens*, 1997 WL 55957, at *12-13. To fulfill that fiduciary duty, the board of directors must meet to discuss the demand for advancement or execute a unanimous written consent reflecting its determination. Under Palladium's theory and the Court of Chancery's ruling, the only circumstance when a director would have the right to mandatory advancement is if the board of directors failed to act on the demand for advancement within 30 days (a time period referenced in Section 2). Stated another way, if the board of directors breaches its fiduciary duty by failing to consider what, under Palladium's theory, could be only a discretionary right to advancement, and simply allows the 30 day time period to lapse, the right to advancement is mandatory. It cannot be the law that Mr. Miller's right to receive mandatory advancement is contingent upon the Palladium board breaching its duties.

The only way the board could "specifically determine[] not to pay a specific advancement" would be to satisfy its fiduciary duties and act on any and all demands for advancement. And, with that being the case, the decision to grant advancement is always discretionary and as such, the use of the word "shall" is rendered meaningless.

Fourth, in reading the word "shall" out of the Bylaw, the Court of Chancery also erroneously rejected Mr. Miller's reasonable reading of Section 5. As noted above, Section 1 grants the right to mandatory advancement. Section 5 details the process of fulfilling that mandatory right for directors and officers. *Stockman v. Heartland Indus. Partners, L.P.* is instructive on this point.

In *Stockman*, the partnership agreement provided, in part:

> *Expenses reasonably incurred* by an Indemnitee in defense or settlement of any claim that may be subject to a right of indemnification hereunder *shall be advanced by the Partnership* prior to the final disposition thereof upon receipt of an undertaking by or on behalf of the Indemnitee to repay such amount to the extent that it shall be determined ultimately that such Indemnitee is not entitled to be indemnified hereunder. *No advances shall be made by the Partnership under this Section 4.4(b)(i) without the prior written approval of the General Partner* or (ii) in connection with an action brought against an Indemnitee by a Majority in Interest of the Limited Partners.

2009 WL 2096213, at *3 (emphasis in original). The partnership argued that the second sentence in this provision gave the general partner discretion to deny approval of an Indemnitee's request for advancement. *Id.* at *5. Such a reading would have eliminated the general partner's discretion in the first provision ("'shall be advanced'") "then reintroduce[e] discretion through the back door" ("'no advances shall be made…without prior written approval'") to bar advancement claims. *Id.* at *6. The court rejected the partnership's argument, finding its reading of the provision unreasonable because "the plain meaning of 'shall be

advanced' is that advancement is mandatory" and therefore giving the general partner "unfettered discretion to deny an advancement request would, in essence, convert the Advancement Provision to a permissive rather than a mandatory term, in contravention of its plain language." *Id.* at *6.

The *Stockman* court went on to further find that the plaintiffs' reading of the above provision, as providing the general partner with a means of policing compliance with the terms of the mandatory advancement provision, was reasonable. *Id.* at *7. The *Stockman* court found that the prior written approval requirement permitted the general partner to ensure that the demand for advancement was appropriate. *Id.* For example, before the general partner had to expend the partnership funds, it could ensure that the requested expenses were reasonable, that claim for advancement arose out of the indemnitee's official covered capacity or whether applicable insurance would be triggered before the partnership was obligated to pay. *Id.* These policing powers were important, the court stated, but they did not give the general partner blanket discretion to deny a proper mandatory advancement request. *Id.*

Similarly, here, Section 5 provides the board of Palladium with the policing powers to ensure that the other conditions of mandatory advancement have been satisfied. In other words, an individual "shall" have the right to advancement "unless" the board, in exercising its policing powers, determines that the individual

seeking the advancement is not qualified. Thus, the Palladium board has the authority: to ensure that the claims for which the director/officer is seeking advancement arose out of his official capacity as required by Section 1 ("by reason of the fact that he, …, is or was a director or officer, of the corporation or is or was serving at the request of the corporation as a director"); to determine whether its obligations under the Bylaws are affected by rights granted pursuant to another agreement, as Section 3 of the Bylaws provides that the Bylaws are not necessarily the exclusive right held by the director/officer[8]; to determine whether any applicable insurance, as referenced in Section 4, must first be exhausted before the corporation begins using its own funds for advancement[9]; to ensure that the undertaking was received; and to ensure that the expenses are reasonable.

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[8] Section 3 provides:

> The rights to indemnification and the payment of expenses incurred in defending a proceeding in advance of its final disposition conferring in this Article X shall not be exclusive of any other right which any person may have or hereafter acquire under any statute, provision of the certification of incorporation, by-law, agreement, vote of stockholders or disinterested directors or otherwise (A53).

[9] Section 4 provides, in part:

> The corporation may purchase and maintain insurance on its own behalf and on behalf of any person who is or was a director, officer, employee, fiduciary, or agent of the corporation or was serving at the request of the corporation as a director, officer…against any liability asserted against him or her and incurred by him or her in any such capacity… (A53-54).

Here, the Court of Chancery rejected Mr. Miller's argument in a conclusory fashion stating "there is no way to isolate the 'unless' provision from the advancement grant provision" and that Mr. Miller "has not conjured up a way to give meaning to the 'unless' phrase" (Op. at 10-11). The lower Court's ruling, however, ignores that reading the "unless" phrase as the policing powers of the Palladium board is consistent with the reasonable expectation that an officer or director of Palladium would have when reading the Bylaws that provide that expenses "shall be paid by the corporation in advance."

II. IF THE BYLAWS ARE AMBIGUOUS, DISMISSAL OF THE ACTION WAS AN ERROR

A. Question Presented

If the Bylaws are ambiguous and after applying the doctrine of *contra proferentem*, do they provide for mandatory advancement?

This question was raised below in Mr. Miller's answering brief in opposition to the motion for judgment on the pleadings (AB 18-20), and in Palladium's reply brief in further support of that motion (RB 12-14).

B. Scope of Review

In an appeal from a decision of the Court of Chancery, the Supreme Court reviews conclusions of law *de novo*. *Stegemeier*, 728 A.2d at 561. The standard of review in a motion for judgment on the pleadings "is to determine whether the court committed legal error in formulating or applying legal precepts." *Desert Equities, Inc.*, 624 A.2d at 1204. If the Supreme Court determines the Bylaws are ambiguous, it can apply the doctrine of *contra proferentem* even if the Court of Chancery did not reach that issue. *See Bank of New York Mellon*, 2013 WL 1136821, at *10.

C. Merits of Argument

An ambiguity exists if the terms of a contract are inconsistent, or where there is more than one reasonable meaning of words or phrases. *See The Liquor Exchange, Inc. v. Tsaganos*, 2004 WL 2694912, at *2 (Del. Ch. Nov. 16, 2004)

(internal citations omitted); s*ee also Eagle*, 702 A.2d at 1232. Under the rules of contract construction, meaning should be given to every term within a contract. *See Stockman*, 2009 WL 2096213, at *7 n.31 (stating the court should "attempt to give meaning to every term in an agreement"). If, under a party's interpretation of contract language, a term is ignored or given no meaning, a court can consider the contract ambiguous and look to extrinsic evidence. *See Winters v. Sea Chase Condo. Ass'n of Unit Owners, Inc.*, 2010 WL 1367749, at *2 (Del. Ch. Mar. 31, 2010) (considering extrinsic evidence because party's interpretation did not give meaning to a term).

As discussed above, (*supra* pp. 14-24), Sections 1 and 5 can (and should) reasonably be read to grant mandatory advancement rights to Mr. Miller. As also discussed above, Palladium's and the Court of Chancery's reading leaves the word "shall" meaningless and results in internal inconsistencies between the use of the words "may" and "shall." Accordingly, Palladium's and the Court of Chancery's reading of the Bylaws is not reasonable.

If this Court finds that Palladium's and the Court of Chancery's reading of the Palladium Bylaws is reasonable, but also finds Mr. Miller's construction is reasonable, then the Palladium Bylaws are ambiguous. This Court may also determine that neither of the interpretations are reasonable and therefore the Bylaws are ambiguous. *Rhone-Poulenc Basic Chemicals Co.*, 616 A.2d at 1196 ("a

contract is ambiguous only when the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings."); *Viking Pump, Inc. v. Liberty Mut. Ins. Co.*, 2007 WL 1207107, at *20 (Del. Ch. Apr. 2, 2007)(finding the contractual language did not "unambiguously reflect[] either of the dueling positions"). If the Bylaws are determined by this Court to be ambiguous, they should be construed against Palladium for the reasons discussed below.

"[I]t is critical that the governing instruments of entities be interpreted consistently and that they be applied in a predictable manner." *Stockman*, 2009 WL 2096213, at *5. Accordingly, courts will construe governing instruments against the entity (by applying *contra proferentum*) in a manner consistent with the expectations of reasonable officers and directors, for example. *Id.* at *5 n.21 (citing *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 398-99 (Del. 1996) (holding that, when faced with ambiguous provisions in preferred stock certificates, "'the Court must construe the document to adhere to the reasonable expectations of the investors who purchased the security and thereby subjected themselves to the terms of the contract' in order to, in part, avoid the drawbacks of disuniform readings of contract provisions that apply to many people."))

Contra proferentum is a principle of construction in which ambiguities in a contract are construed against the drafter. *See Twin City Fire Ins. Co. v. Delaware*

Racing Ass'n, 840 A.2d 624, 630 (Del. 2003) (citations omitted). When the language of a contract is ambiguous, it should be construed most strongly against the party that drafted it. *See Rhone-Poulenc Basic Chems. Co.*, 616 A.2d at 1195; *see also Greco v. Columbia/HCA Healthcare Corp.*, 1999 WL 1261446, at *13 (Del. Ch. Feb. 12, 1999) (in advancement case, construing ambiguous language against corporation and in favor of the claimant); *Stockman*, 2009 WL 2096213, at *5 n.21 (applying the doctrine of *contra proferentum* to advancement provision in partnership agreement and granting summary judgment to former officers/directors because "to the extent there is any ambiguity…, that ambiguity must be construed in favor of [the officers]").

This Court recently applied the doctrine of *contra proferentem* in an action involving the interpretation of a limited liability company operating agreement. *See Bank of New York* Mellon, 2013 WL 1136821. The lower Court had concluded that the key definition of "Parity Securities" in the agreement was unambiguous and ruled in favor of defendants on crossing motions for summary judgment. This Court ruled that the key definition was ambiguous and applied the doctrine of *contra proferentem. Id.* at *9. The lower Court's decision was reversed and the case was remanded "with instructions to the Court of Chancery to enter final judgment for the Trustee on count I (declaratory judgment) and count II (specific performance), consistent with the rulings in this Opinion." *Id.* at *14.

This Court stated that a company is '"better able to clarify unclear ... contract terms in advance so as to avoid future disputes and therefore should bear the drafting burden that the *contra proferentem* principle would impose upon it."' *Id.* at *9.

Construing the Bylaws against Palladium results in only one conclusion, the Bylaws provide for mandatory advancement. The plain language of the Bylaws – "shall include the right to be paid …in advance of its final disposition" and "Expenses…shall be paid…in advance of such proceeding's final disposition" - creates the expectation of a reasonable director or officer that he or she is entitled to mandatory advancement (A53-54). In addition, for the reasons stated in Section I, *supra*, this is the only reading that gives all the provisions of the Palladium Bylaws meaning.

If, after applying *contra proferentum*, the Court still finds that the Bylaws are ambiguous, the lower Court's decision must be reversed and the case remanded so that the Court of Chancery may review extrinsic evidence to determine the parties' intent. *See Sun-Times Media Group, Inc.*, 954 A.2d at 389 (finding advancement bylaws were ambiguous and analyzing extrinsic evidence).

CONCLUSION

For the reasons discussed above, the decision of the Court of Chancery should be reversed and the matter remanded.

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